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SUBJECT: PM BROWN HOSTS SUMMIT: PROPOSALS FOR STABILITY IN
GLOBAL FINANCIAL MARKETS

REF: LONDON 00116

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SUMMARY:

¶1. (SBU) Summary. On January 29, UK Prime Minister Brown, together with German President Merkel, French President Sarkozy, Italian PM Prodi, and EU President Barroso, issued a joint communique proposing steps to enhance transparency and promote stability in the global financial markets. The leaders said that the European economy remains fundamentally strong and reaffirmed their commitment to an open global economy. They stressed the need for private sector solutions backed by regulation to enhance transparency in the financial sector; to finish and implement the crisis management work of the EU and Financial Stability Forum (FSF); and to seek a new role for the International Monetary Fund to oversee global macro financial stability (see para 7 for key excerpts). According to a contact in the Cabinet Office, there was complete agreement on the communique; the leaders asked Brown to lead on these issues at the July G8 Summit and Brown agreed to support EU membership in the FSF. End Summary.

¶2. (U) At the October 2007 Lisbon EU Summit, Brown, Merkel and Sarkozy signed an ad hoc trilateral statement regarding financial market developments and agreed to meet to discuss how they might steer the work of the EU regarding long term decisions to ensure economic stability. The meeting took place on January 29; participation was expanded to include Italy and the EU, see reftel. Brown read the communique at a press conference following the meeting at which each leader took a question from the press.

¶3. (SBU) Simon Girdlestone, ECOFIN Desk Officer, European Secretariat at the Cabinet Office told Econoff on January

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30 that there was complete agreement on the communique, which was not changed from the initial draft. Girdlestone said that there were no divergent views expressed regarding either the need for added regulation or the need to resist protectionism. He also confirmed that Brown agreed to support EU membership in the FSF.

¶4. (SBU) It was surprising that the five leaders were in such complete agreement on the issues discussed that there

were no changes to the draft communiqu, Girdlestone added. At the press conference, each leader answered a single question from a member of their press corps. In his remarks, Barroso also referred to the EUQs future participation in the FSF. HM Treasury contacts had previously noted to Econoff that the UK felt it would be helpful to have the EU as a member of the FSF, but that the UK would not propose EU membership. Consistent with this view, Girdlestone confirmed that Brown said at the summit the UK would support EU membership.

15. (SBU) Girdlestone said that PM Brown had been tasked with raising the issues in the communiqu at the July G8 Summit in Japan.

16. (SBU) The communiqu reference to an agreement on the Doha round being essential to an open global economy reflected the view of all five leaders, according to Girdlestone.

The Communiqu

17. (SBU) Relevant excerpts below. See full text of communiqu at <http://www.number10.gov.uk/output/Page14443.a sp>

Begin excerpts of joint communiqu:

WORLD ECONOMY

The fundamentals of the European economies remain strong with employment still rising. They are thus well placed to face the challenges presented by heightened global uncertainty. As the leaders of the major European economies we remain committed to cooperating closely to maintain economic stability, and to strengthening and deepening economic reform. At this time of global uncertainty we need to signal our commitment to an open global economy. An ambitious and balanced agreement on the Doha round, to

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which we are committed, is essential to this.

FINANCIAL MARKETS

We look forward to discussing the outcome of the work currently underway in the Financial Stability Forum, and to discussing at the Spring European Council Ecofin's work to examine the causes and proper response to recent financial market turbulence.

In developing a longer term response we should be guided by three principles:

-First, primary responsibility for managing risk is and must remain with individual financial institutions and investors.

-Second, this needs to be backed up by strengthened national regulatory and supervisory frameworks.

-Third, regulatory authorities in different countries need to cooperate and exchange information effectively in the EU and internationally to prevent and manage crises and contagion.

More immediately, however, we must rebuild confidence and increase the transparency of financial markets, institutions, and the instruments they trade by: improving the quality of the information available to investors on structured products, including in relation to their valuation; enhancing the understanding and management of risk; and avoiding possible conflicts of interest.

To this end we call for:

-improvements in the information content of credit ratings to increase investors' understanding of the risks associated with structured products, and for action to address potential conflicts of interest for rating agencies. While preferring market-led solutions, such as the amendment of the IOSCO code of conduct, if market participants prove unable or unwilling to rapidly address these issues we stand ready to consider regulatory alternatives;

-improvements in the understanding of banks' and other financial institutions' exposure to off balance sheet vehicles. We call upon the major audit firms and supervisors to deliver clear and consistent guidance on valuation and disclosure of such risks; and

-prompt and full disclosure of losses banks and other financial institutions that would help reduce uncertainty and improve confidence in financial markets;

-improvements in EU early warning on financial stability through regular reporting from the Level 3 committees (CEBS, CEIOPS and CESR);

-market participants, the FSF and the EU to act rapidly to ensure adequate transparency and disclosure about how structured products are valued, that uncertainties around those valuations are clear and that risks are well managed

The Basel Committee of Banking Supervisors should bring forward standards on improving the international management of liquidity risk. Additionally, we need to improve dialogue between supervisors and firms about risk management and stress testing.

Market orientated solutions are crucial to achieving the necessary improvements in business operations and in interactions between market participants. We therefore welcome the voluntary best practice standards presented by the London-formed Hedge Fund Working Group on 23 January 2008 in the context of the Financial Stability Forum's five recommendations on hedge funds.

INTERNATIONAL AND EU COOPERATION

It is also important to ensure the work already underway in the Financial Stability Forum and the EU to improve crisis prevention and management is concluded and implemented as soon as possible. This should include:

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-measures to foster the effectiveness of EU networks of financial supervisors and to ensure strong and effective supervision of cross border groups;

-common principles for international financial crisis management;

-a common analytical framework for the assessment of the systemic implications of a potential crisis;

-common practical guidelines for crisis management, including improved information exchange; and

-closer cooperation between countries with particularly important links at firm or capital market level.

REFORM OF THE INTERNATIONAL INSTITUTIONS

We need a better early warning system for the global economy and we need to ensure that its warnings have the force and authority to ensure that they are acted upon. To this end:

-in the short term the IMF and Financial Stability Forum

need to report at the next IMF meetings on the threats to the global economy from financial sector developments. This will improve transparency about risks in the financial sector and how markets and regulators are responding. The IMF and FSF should also present as soon as possible proposals on how they will further enhance their cooperation.

-in the longer term we should consider how to strengthen and clarify the IMF's responsibility to oversee macro financial stability.

END Excerpts

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